ANNUAL REPORT

OF

THE KROGER GROCERY & BAKING COMPANY

FOR THE FISCAL YEAR ENDED DECEMBER 28, 1935

The Kroger Grocery & Baking Company

Executive Offices: 35 East Seventh Street
CINCINNATI, OHIO

OFFICERS

ALBERT H. MORRILL, *President and General Manager*

CHARLES M. ROBERTSON, *Vice-President and Treasurer*

L. J. HUERKAMP, *Secretary*

J. H. SADLER, *Ass't. Sec'y. and Ass't. Treas.*

F. M. GRIEME, *Assistant Treasurer*

T. S. BURNS, *Assistant Secretary*

J. M. MARKLEY, *Assistant Secretary*

DIRECTORS

R. G. CLARK, Cincinnati
Vice-President and General Manager, Piggly Wiggly Corporation

WALTER A. DRAPER, Cincinnati
President, The Cincinnati Street Railway Company

CHARLES W. DUPUIS, Cincinnati
President, The Central Trust Company

HARRY J. GILLIGAN, Cincinnati
John J. Gilligan & Son

G. A. GINTER, Cincinnati
Member Firm, Nichols, Morrill, Wood, Marx & Ginter

JOHN M. HANCOCK, New York
Partner, Lehman Brothers

L. J. HUERKAMP, Cincinnati
Secretary, The Kroger Grocery & Baking Company

CHESTER F. KROGER, Cincinnati
Capitalist

FRED LAZARUS, JR., Columbus
Vice-President & Treasurer, The F. & R. Lazarus & Co.

JAMES O. MCKINSEY, Chicago
Board Chairman, Marshall Field & Co., Inc.

ALBERT H. MORRILL, Cincinnati
President, The Kroger Grocery & Baking Company; Piggly Wiggly Corporation

CHARLES M. ROBERTSON, Cincinnati
Vice-President and Treasurer, The Kroger Grocery & Baking Company

JOHN R. RONEY, Chicago
Vice-President, Consumers Sanitary Coffee and Butter Stores (Chicago Branch of The Kroger Grocery & Baking Company)

PUBLIC AUDITORS

Lybrand, Ross Bros. & Montgomery

GENERAL COUNSEL

Nichols, Morrill, Wood, Marx & Ginter

TRANSFER AGENTS

The Provident Savings Bank and Trust Company, Cincinnati

Bankers Trust Company, New York

REGISTRARS

The Central Trust Company, Cincinnati

The Commercial National Bank and Trust Company of New York, New York

February 8, 1936

To the Shareholders of

The Kroger Grocery & Baking Company:

At the present time any report to our shareholders will be incomplete without at least a brief comment on the general situation of the industry of which your company is a part.

Previous to 1920, the business of distributing foodstuffs had not kept pace with the improvements in production or even in other lines of retailing. Such improvement as had taken place in the distribution of foods was largely confined to the chains. The most rapid development of the chains, both in the number of corporate organizations and the number of outlets, took place between 1920 and 1930. During this decade the chains, developing by leaps and bounds, blazed a trail and led the way toward better methods of food merchandising, resulting, it is generally conceded, in lowering prices and improving service to the consumer.

Since 1930, the number of retail outlets of grocery chains has actually declined, while the number of independently owned grocery stores has increased, according to official government statistics. Through the years of the depression, the independent store owners have to a large extent associated themselves together in what are known as voluntary chains, which leave the ownership of the store in the individual, but provide economy in buying, better store arrangement and sometimes a common name. The result has been that the independently owned store today enjoys many of the advantages which were formerly found only in the chains.

Agitation against the chains, evidenced by the demand for discriminatory taxation and by investigations such as that being conducted at present by a Congressional Committee, is based on the claim, by wholesalers and the stores to which they sell, that chains have a material and unjustified advantage over the independently owned store. Some real advantages the chains have, and will continue to have, but an unprejudiced and thorough investigation, conducted by the Federal Trade Commission under the Brookhart Resolution, showed that these advantages resulted from economy of operation and were in no sense unjustified or discriminatory. The so-called discounts or confidentials recently given wide publicity are in fact essentially the same as those received by others engaged in food distribution. Particularly is this so in the case of the voluntary chains. But the discounts received by both corporate and voluntary chains are for services rendered. They merely amount, in the aggregate, to similar discounts paid to various intermediary agencies when food distribution is accomplished by passing through a number of different and successive hands.

The final effect of distribution through the chain system is that savings effected are divided between the producer, the consumer and the distributor. Definitely this does not give to the corporate chains an unfair profit. Competition in food distribution is entirely too aggressive to allow anything beyond a narrow margin of profit.

Any system which decreases the cost of distribution is fundamentally sound. An organization operating multiple retail units under unified management does cut the cost of distribution. The complaint against it is not that it maintains or increases its prices to the consumer, thus adding to its profit, but that it decreases the price to the consumer, thus eliminating the middleman and increasing competition with the independents. The competent merchant among the independents is amply able to compete with the chains and is doing so successfully. The middleman represents a very small number as compared to consumers and producers who are actually benefited by the chains. We can not believe that any industry which decreases the cost of distribution and hence lowers the cost to the consumer and benefits the producer can be permanently and ultimately burdened by discriminatory taxes and regulations.

Directors and Officials

Our Board of Directors has suffered two losses during the year 1935.

Mr. Otto Armleder, for many years a large stockholder in the company, died. During the years he served on the Board he was actively interested in and deeply concerned with the operations of the company. He rendered valuable service and the company suffers a real loss by reason of his death.

Colonel C. O. Sherrill, for five years a Vice-President, resigned to accept the Presidency of the American Retail Federation. His services to the company were varied and valuable, particularly in the field of Public Relations and Engineering, and he contributed in full measure to whatever progress or success the company may have had during the past five years.

The vacancies created in the Board were filled by the election of Mr. Harry J. Gilligan, of Cincinnati, who represents a substantial stock interest, and the election of Mr. James O. McKinsey, of Chicago, who, for five years has been advisor to the company on matters of organization, personnel and accounting practices and methods.

Sales Total sales for the fiscal year 1935 (52 weeks) amounted to $229,907,884, compared with $221,175,330 in 1934 (52 weeks), an increase of $8,732,554, or 4%.

Accurate figures of the average increase in retail food prices in 1935 as compared with 1934 are not available, but the percentage increase in food prices was undoubtedly larger than our percentage increase in sales. Hence a decline in total tonnage is indicated.

Average weekly sales in 1935 were $1,018 per store as compared with $968 in 1934, an increase of $50 per store or 5.2%.

Earnings The attached Consolidated Income Account for the fiscal year 1935 shows final net income of $4,110,925.98, after Federal Income Taxes. This is equivalent, after preferred dividends, to $2.25 per share on the 1,821,989 shares of common stock outstanding in the hands of the public at the end of the year, compared with final net income for 1934 of $4,198,241.74 or $2.31 per share.

Of the above final net income, $203,498.40 represents dividends received from your company's subsidiary, Piggly Wiggly Corporation, and $467,450.69 represents amounts charged against earnings of prior years, and recovered in 1935 because of the invalidity of chain store tax laws. This recovery amounts to 26 cents per share.

The decline in earnings in 1935 as compared with 1934, was due largely to a decline in gross profit. As stated in detail later in this report, a substantial decrease in expenses was attained in 1935, but the lag between increase in wholesale prices and increase in retail prices, and the serious price competition throughout our territory decreased our gross profit materially. To this decrease in gross profit is attributed in large measure the decrease in net profit, although serious labor difficulties in some of our operations may have contributed in part to this decrease. The elements of the lag between wholesale and retail prices and price competition have been continuous for the last eighteen months.

Expenses The operating and administrative expenses in 1935 as compared with 1934 showed a decrease of $220,902. This decrease was accomplished despite an increase in what we term Kroger Brand and Institutional Advertising, amounting to $190,000, and in total wages paid amounting to $159,079. Comparing 1935 operating expenses with those of 1934, after eliminating the increase in the cost of Kroger Brand and Institutional Advertising, there was an actual decrease of $410,902 in operating expenses. Kroger Brand and Institutional Advertising showed satisfactory results.

Self-Insurance After a thorough survey, the company elected, as of November 1, 1935, to carry its own liability on those lines which constituted the major portion of our insurance premium expense. The self-insurance program is being carried out in accordance with sound insurance principles. Indemnity against unusual or excessive losses has been provided for. In adopting the program it is expected that a substantial saving will be realized and our experience to date definitely supports this expectation.

Depreciation As shown by the Income Account, the company continued substantially the same depreciation policy and rates as in 1934.

Inventories At the beginning of the fiscal year 1935, inventories amounted to $20,916,910.15. On June 15, 1935 (end of the first six periods), inventories amounted to $18,970,660.68. At the end of the fiscal year 1935 inventories amounted to $20,129,096.98, a decrease as of December 28, 1935 under December 29, 1934 of $787,813.17 or 3.8%. The company has pursued a conservative policy on inventories due largely to the uncertainty of the general price structure.

Cash Position and Current Ratio The graphs on page 14 illustrate the comparison of cash position and current ratio on December 28, 1935, as compared with December 29, 1934.

Loans On December 28, 1935, your company had no bank loans, and has had none to the date of this report since early in 1931.

Capital Structure As of December 28, 1935 the amount of common stock issued and outstanding was 1,830,885 shares. On that date the number of shares outstanding upon which dividends must be paid was 11,696 shares larger than on December 29, 1934, and numbered 1,821,989 shares. This increase was caused by the exercise of stock options by some of the officers and executives during the year, on 11,697 shares, less an increase of 1 share in treasury stock through the acquisition of fractional units.

There is no capital obligation of the company outstanding ahead of the common stock except that of $104,100 par value preferred stock.

Shareholders The number of common shares outstanding and number of shareholders are shown on page 15. An analysis of our stock records shows the interesting fact that during 1935 the number of our shareholders increased in forty-three states and the increase in Ohio was more than in any other state. Evidently public ownership of your company's stock is becoming increasingly diversified. It is worthy of note that the number of our shareholders is practically identical with the number of our employees. Your company, while large, does not represent any one individual, class or community. It is owned by a large number of small shareholders who give employment to approximately the same number of employees.

Store Maintenance, Expansion and Closing At the end of the fiscal year 1935 we were operating 4,250 grocery stores, 102 (2.3%) less than the 4,352 stores operated at the close of the fiscal year 1934.

The average number of grocery stores in operation during 1935 was 4,286, which is 70 (1.6%) less than the average number of 4,356 stores operating during 1934.

At the end of 1935, we operated 2,653 meat markets, 95 (3.5%) less than the 2,748 in operation at the end of 1934.

The average number of meat markets operated during 1935 was 2,694 or 51 (1.9%) markets less in average number than the 2,745 operated during 1934.

The decrease in number of retail outlets has been continuous for the past five years. The percentage of decrease at the end of 1935 as compared with 1934 is less than in previous years. But this does not necessarily indicate a trend. A decline in numbers will probably continue because, in the interest of economy, wherever possible and advisable we are combining small outlets into one large outlet.

In 1935 there were 71 new stores opened and 299 either remodeled or relocated as compared with 73 new stores opened and 258 either remodeled or relocated in 1934. During 1935 your company expended on refinishing new stores and remodeling old stores an aggregate of $1,212,763 compared with an expenditure for the same purpose in 1934 of $1,293,613.

During the past year, a unit of 25 stores, located in Atlanta, Georgia, operating under the Piggly Wiggly name, was acquired by your subsidiary, Piggly Wiggly Corporation, in liquidation of a debt. As Piggly Wiggly Corporation is not an operating company this unit was purchased by your company.

Merchandising and Operations The decentralization of these activities, which has been in progress for a number of years, was continued during 1935. Our business is in the stores. In the interest of flexibility and the development of individual initiative, we are constantly endeavoring to move authority and freedom of action toward the stores. More progress in this direction has been made in 1935 than during preceding years.

Manufacturing It has been the policy of your company for many years to manufacture or package its own merchandise wherever such activities are justified by volume and profit. This policy has been pursued during 1935 and some additional items have been added to our own manufactured products.

Your company has long been engaged in the packing of meat products. While this activity supplies only a small part of our company requirements, yet it seems an essential part of our business. Our former Cincinnati meat packing plant was abandoned during 1935. We have erected and are now operating a thoroughly modern meat processing plant in Cincinnati. In this plant we do not kill, as in the old plant, but store meat carcasses and process them into various kinds of meat products.

Personnel It is the consensus of opinion among all informed persons that on personnel in a grocery chain depends 90% of the efficiency and effectiveness of the company. Your company is no exception to the rule. As a consequence, we have through past years spent much time and large sums on training of our personnel.

Our turnover, which had shown constant improvement until the latter part of 1935, unfortunately has increased. Perhaps this was to be expected with the improvement in business conditions, but it nevertheless represents a real problem. Our relations with our employees, which had been most satisfactory, also suffered a setback in the closing periods of 1935. Labor disputes, based on demands for the closed shop for stores, occurred in three branches, and have affected our sales and profits in these branches. There has been no dispute over wages and hours. We do not see how a closed shop can work in a retail store, nor how it will benefit either our employees or our company because the relationship between customer and retail salesman is so personal and changeable, even from day to day, that it can not be standardized successfully.

At the end of 1935, we had 21,611 employees as compared with 22,023 at the end of 1934. This change of number in the main is caused by the decrease in the number of stores.

Our employee training program was extended during 1935. In our training schools during the year, 1,035 prospective store and market managers were trained and graduated. These graduates were drawn largely from the ranks of our store clerks, thus pursuing the policy of advancing men from our own ranks.

The Kroger Employees Mutual Benefit Association, entirely employee officered and managed, completed its third year, with 90% of our eligible employees protected by group insurance, provided through this association. The Credit Unions (small employees' savings and loan associations supervised by KEMBA) had a membership of 9,159 employees and had on deposit from employees at the close of the year $374,659, of which $323,456 had been loaned in small amounts to 4,183 members.

Piggly Wiggly Corporation This company, 99% of the stock of which is owned by your company, made some progress during 1935. Its earnings justified the declaration of a dividend and your company's earnings for 1935 were augmented by $203,498.40, received in dividends from this source.

Taxes There have been enclosed with your dividend checks on two occasions during the year striking statements illustrating the extent to which the burden of taxation has increased. There are indications that taxes will increase in 1936. Taxes for 1934, direct and indirect, paid by or through your company, are estimated as equivalent to approximately $10 a share or 8.5% of sales or 39% of invested capital. Similar taxes for 1935 are estimated, with reasonable accuracy, as having been equivalent to $12 a share or 10% of sales or 45% of invested capital.

Under one item of the Social Security tax program alone, the Unemployment Insurance provision, effective January 1, 1936, at the rate of 1% of our payroll, our taxes will increase approximately $330,000, or eighteen cents per share. Old Age Pension taxes, effective January 1, 1937, at 1% of the payroll plus the increase of an additional 1% in 1937 in the Unemployment Insurance tax rate, will increase our taxes in 1937 approximately $990,000, or fifty-four cents a share over 1935. Taxes under the Social Security Act increase progressively until 1949.

At the date of this report, only one of the states in which we operate, Wisconsin, had enacted laws covering unemployment or old age pensions. Hence, we do not know the exact cost to us of these taxes.

Your company, however, is charging against current operations an amount equal to 1% of payroll, which is the amount for 1936 payable under the Federal Social Security Act.

Public Relations In our annual report for the year 1931 and in each succeeding report we have informed our shareholders of our activities in the field of public relations. These embrace not only contacts in the field of governmental activities, both national and state, but also in the field of various civic and business organizations throughout our territory. We have endeavored to make clear to our shareholders in each of these reports that we were doing everything in our power to become a part of the communities we serve and to prevent the enactment of discriminatory class legislation, which we conceive to be inherently unsound and inimical to the best interests of our shareholders and employees.

Such legislation enacted or threatened by both national and state governmental agencies, during 1935, has assumed increasing importance. In many cases, such legislation is conceived and promoted by officials who are not familiar with our business and who are without information as to the facts pertaining to it. To bring to such officials and to the public generally the actual facts regarding our business is time-consuming and expensive.

Attention to such legislation and resisting it by all legitimate means occupies an increasing amount of the time of the officials of your company. We would consider ourselves negligent in the performance of our duties as trustees for our shareholders and as officers for our employees if we did not resist ill-advised and improper laws and regulations imposed on the business of your company. We propose to continue this policy as far as our means and abilities permit.

To the members of our Board of Directors, all of whom have given freely and continuously of their abilities and services in the solution of our many problems, and to our personnel, on whom the conduct of the business mainly depends, we extend our thanks and appreciation for their contributions to the success of your company during 1935.

Respectfully submitted,

President

The Kroger Grocery & Baking Co

CONSOLIDATED BALANCE SHEETS, DEC

ASSETS	December 28, 1935	December 29, 1934
CURRENT:		
Cash in banks and on hand	$10,158,664.22	$ 7,951,225.85
United States Government securities, at par 1935; at cost 1934; par value of securities held in escrow 1935, $27,500; 1934, $855,500 (Quoted market prices 1935, $400,985; 1934, $882,746)	398,000.00	872,574.83
County and municipal bonds, at par; par value of securities held in escrow 1935, $10,000 (Quoted market prices 1935, $286,709; 1934, $272,790)	281,000.00	268,000.00
Notes and accounts receivable, net of allowance for those doubtful of collection:		
Customers, including welfare associations and relief agencies	$ 1,307,364.23	$ 1,626,737.65
Employees	8,685.84	22,018.90
Claims, advances, etc.	503,412.81	321,216.33
	$ 1,819,462.88	$ 1,969,972.88
Inventories of merchandise, at lower of cost or market	$20,129,096.98	$20,916,910.15
Prepaid insurance, rent, taxes, etc.	450,898.68	509,050.20
Accrued accounts receivable, not due	210,533.48	235,225.22
TOTAL CURRENT ASSETS	$33,447,656.24	$32,722,959.13
Deferred claims receivable, net of provision for possible losses	$ 365,590.17	$ 409,070.35
Investments, at ledger values:		
Stock of subsidiary company, not included in consolidation, at cost	$ 6,066,459.99	$ 6,064,742.49
Other stocks, bonds, and mortgage notes, etc.	186,049.93	88,192.22
	$ 6,252,509.92	$ 6,152,934.71
Common stock of company held for sale to employees (1935, 8,896 shares; 1934, 20,593 shares)	$ 97,157.05	$ 224,905.02
Cash and certificates of dividend accumulation held for use and benefit of employees under group insurance plan (Contra)	$ 124,838.41	$ 86,829.75
FIXED ASSETS:		
Land and buildings, as appraised by The American Appraisal Company, Harry S. Cutmore and Associates, C. G. Richardson, C. E., and the real estate department of the company, as at January 1, 1933, with subsequent additions, at cost:		
Land	$ 1,389,532.86	$ 1,408,288.80
Buildings	$ 8,723,574.92	$ 8,373,546.53
Machinery and equipment, as appraised by The American Appraisal Company, as at January 1, 1933, with subsequent additions, at cost	16,323,654.05	15,903,650.47
Automotive equipment, etc., at cost	3,036,254.81	2,928,605.81
	28,083,483.78	27,205,802.81
Less, Allowance for depreciation and obsolescence	13,803,524.52	13,040,693.64
	$14,279,959.26	$14,165,109.17
TOTAL FIXED ASSETS	$15,669,492.12	$15,573,397.97
Store and general supplies and deferred charges to future operations	$ 514,329.94	$ 524,743.97
	$56,471,573.85	$55,694,840.90

pany and Subsidiary Companies
MBER 28, 1935 AND DECEMBER 29, 1934

LIABILITIES		December 28, 1935		December 29, 1934
CURRENT:				
Accounts payable, vendors, etc.		$ 4,450,785.07		$ 4,190,206.07
Accrued expenses, taxes, etc.		1,381,603.37		2,267,545.09
Provision for federal taxes, current and prior years		1,062,936.12		1,061,210.93
Dividends payable		1,722.50		1,803.00
TOTAL CURRENT LIABILITIES		$ 6,897,047.06		$ 7,520,765.09
Provision for self insurance		145,934.32		92,835.40
Provision for rentals of closed stores, not yet due		249,630.97		293,210.37
		$ 7,292,612.35		$ 7,906,810.86
Amounts due employees representing dividends and premium refunds on group insurance held by company for the use and benefit of employees (Contra)		$ 124,838.41		$ 86,829.75
CAPITAL AND SURPLUS				
Preferred capital stock outstanding:				
First preferred, 6 pct. par $100		$ 55,700.00		$ 55,800.00
Second preferred, 7 pct. par $100		48,400.00		55,200.00
		104,100.00		111,000.00
Common capital stock without par value: (Authorized 3,000,000 shares)				
	Shares		*Shares*	
Issued	1,848,278		1,848,278 6/20	
Less, In Treasury	17,393		17,392	
Outstanding	1,830,885	33,398,249.80	1,830,886 6/20	33,398,276.30
Capital surplus, as annexed		1,047,760.62		883,083.59
Earned surplus, appropriated for contingent uninsured losses		93,161.85		96,388.56
Earned surplus, as annexed		14,410,850.82		13,212,451.84
		$49,054,123.09		$47,701,200.29
		$56,471,573.85		$55,694,840.90

The Kroger Grocery & Baking Company and Subsidiary Companies

CONSOLIDATED CAPITAL SURPLUS ACCOUNT

for the period from December 29, 1934 to December 28, 1935

Balance, December 29, 1934	$ 883,083.59
Add:	
Profit from sale of 11,697 shares of The Kroger Grocery & Baking Company common stock	164,677.03
Capital surplus, December 28, 1935	$1,047,760.62

CONSOLIDATED EARNED SURPLUS ACCOUNT

for the period from December 29, 1934 to December 28, 1935

Balance, December 29, 1934	$13,212,451.84
Add:	
Net income for the fiscal period ended December 28, 1935, as annexed	4,110,925.98
	17,323,377.82
Deduct:	
Cash dividends paid in the fiscal period ended December 28, 1935	2,912,527.00
Earned surplus, December 28, 1935	$14,410,850.82

The Kroger Grocery & Baking Company
and Subsidiary Companies

CONSOLIDATED INCOME ACCOUNT

for the periods from December 29, 1934 to December 28, 1935
and from December 31, 1933 to December 29, 1934

	Fiscal period ended December 28, 1935	Fiscal period ended December 29, 1934
Net Sales	$229,907,884.36	$221,175,330.78
Cost of sales, including warehousing and transportation expenses	182,576,691.42	172,909,674.89
	$ 47,331,192.94	$ 48,265,655.89
Operating expenses, excluding depreciation	$ 39,380,553.70	$ 39,620,700.65
Administration expenses	2,081,788.56	2,062,543.39
	$ 41,462,342.26	$ 41,683,244.04
Profit from operations before allowance for depreciation	$ 5,868,850.68	$ 6,582,411.85
Allowance for depreciation	2,290,652.60	2,356,200.10
	3,578,198.08	4,226,211.75
Interest earned, net of interest paid	41,938.09	95,121.34
Profit from operations and other income, excluding income from subsidiary and affiliated sources, unusual income, and federal income taxes	3,620,136.17	4,321,333.09
Net accrued earnings of subsidiary and affiliated companies for fiscal years (includes dividends of $203,498.40 in 1935, and $186,477.50 in 1934 received from a subsidiary not included in consolidated statements. The earnings are in excess of dividends received.)	500,512.00	465,019.49
Profit before unusual income and federal income taxes	4,120,648.17	4,786,352.58
Taxes charged against income of prior years and recovered in 1935 because of the invalidity of certain chain store tax laws, less federal income taxes thereon	467,450.69	——
	4,588,098.86	4,786,352.58
Federal income taxes, estimated	477,172.88	588,110.84
Net income	$ 4,110,925.98	$ 4,198,241.74

LYBRAND, ROSS BROS & MONTGOMERY
ACCOUNTANTS AND AUDITORS
CAREW TOWER
CINCINNATI

WILLIAM M LYBRAND
T EDWARD ROSS
ROBERT H MONTGOMERY
JOSEPH M. PUGH
WALTER A. STAUB
H H DUMBRILLE
JOHN HOOD, JR.
HOMER N SWEET
T B G HENDERSON
GEORGE R KEAST
PRIOR SINCLAIR
NORMAN J. LENHART
DONALD P PERRY

A CHARLES GUY
RESIDENT PARTNER

NEW YORK
PHILADELPHIA
CHICAGO
BOSTON
NEWARK
BALTIMORE
WASHINGTON
PITTSBURGH
DETROIT
CLEVELAND
CINCINNATI
ROCKFORD
LOUISVILLE

ST LOUIS
ATLANTA
DALLAS
HOUSTON
SAN FRANCISCO
LOS ANGELES
PORTLAND
SEATTLE

LONDON
PARIS
BERLIN

The Board of Directors,
The Kroger Grocery & Baking Company,
Cincinnati, Ohio.

We have made an examination of the consolidated balance sheet as at December 28, 1935, and the consolidated statements of income, earned surplus, and capital surplus for the year 1935 of The Kroger Grocery & Baking Company and subsidiaries. In connection therewith, we examined or tested accounting records of the companies and other supporting evidence and obtained information and explanations from officers and employees of the companies; we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

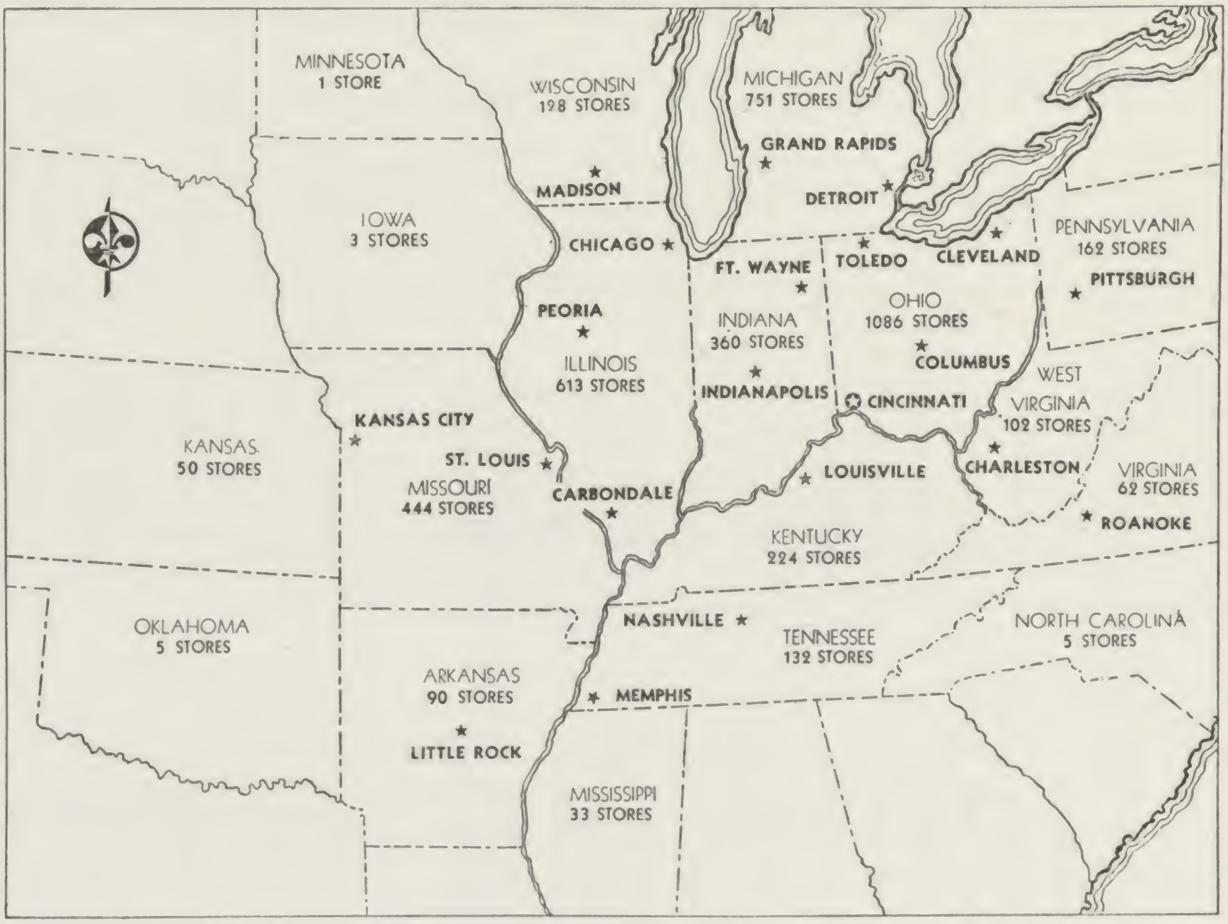
The income statement includes taxes charged against income in prior years and recovered in 1935 because of the invalidity of certain chain store tax laws. National and general advertising costs included as administrative expenses in prior years have been reclassified in the income statement for 1935 and 1934 and included with the operating expenses.

In our opinion, based upon such examination, the accompanying consolidated balance sheet and related consolidated statements of income and surpluses fairly present, in accordance with accepted principles of accounting consistently maintained by the companies during the year under review, their position at December 28, 1935 and the results of their operations for the year then ended.

Cincinnati, Ohio,
February 5, 1936.

Lybrand Ross Bros & Montgomery

MAP OF KROGER OPERATIONS



The map shows the location of branch headquarters cities. In each of these cities a warehouse, a transportation unit and an office are maintained. It also shows the number of stores in operation in each of the eighteen states in which your company was operating at the close of the fiscal year.

In addition to the facilities maintained in branch headquarters cities, subwarehouses, located at strategic points, facilitate distribution to stores in surrounding communities. The company operates one or more stores in each of 1514 towns and cities.

Manufacturing operations are conducted in fifteen cities conveniently located throughout the company's territory.

Bakeries are operated in thirteen cities, namely Chicago, Cincinnati, Cleveland, Columbus, Detroit, Fort Wayne, Grand Rapids, Indianapolis, Louisville, Madison, Memphis, Roanoke and St. Louis.

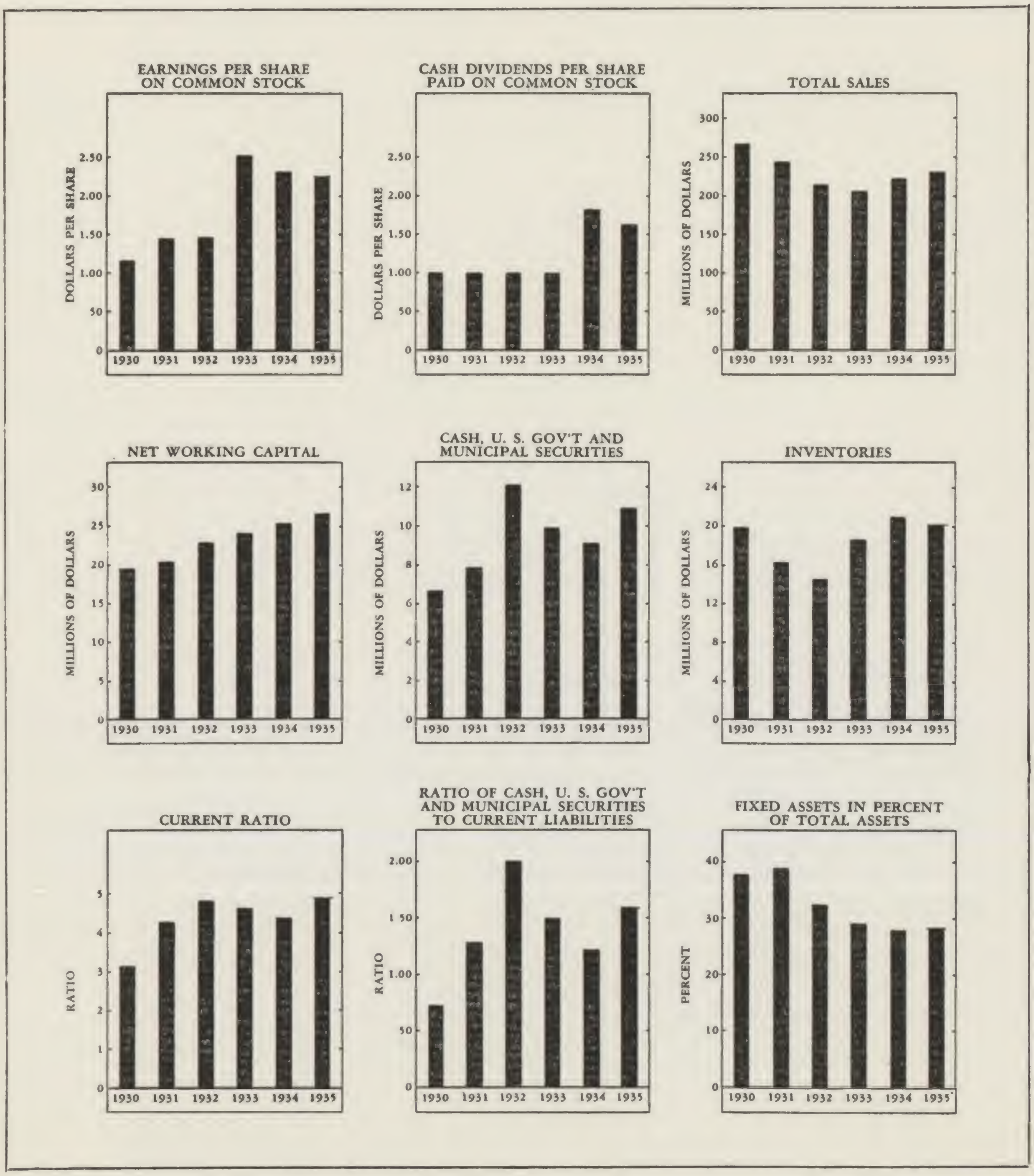
Coffee roasting plants are situated in Cincinnati and St. Louis.

Dairies are operated in Cincinnati, Dayton, Grand Rapids, Indianapolis and Toledo.

A meat distributing and processing plant is located in Cincinnati, and a packing plant is operated in Columbus.

Other manufacturing operations of the Kroger Company include beverage plants, a printing plant, and laundries at suitable locations. In a factory in Cincinnati, various food products are processed and packaged for sale in the company's stores under its brand names. A factory manufacturing store fixtures and equipment is operated at Jackson, Tennessee, by a Kroger subsidiary.

The Kroger Grocery & Baking Company
and Subsidiary Companies



The Kroger Grocery & Baking Company
and Subsidiary Companies

FINANCIAL AND OPERATING STATISTICS FOR THE FISCAL YEARS 1930 TO 1935, INCLUSIVE

	1930	1931	1932	1933	1934	1935
PROFIT AND DIVIDENDS						
Final Net Profit—Dollars Per Share	1.14	1.46	1.47	2.51	2.31	2.25
—Total Dollars...	2,168,247	2,731,128	2,740,867	4,546,203	4,198,241	4,110,926
Cash Dividends Paid Per Common Share	1.00	1.00	1.00	1.00	1.80	1.60
STOCK						
Number Shares Common Stock outstanding with Public—End of Year	1,813,486 6/20	1,813,486 6/20	1,811,091 6/20	1,792,366 6/20	1,810,293 6/20	1,821,989
Number Shareholders—End of Year	16,945	18,856	20,680	19,605	20,633	22,537
SALES						
Total Sales—Dollars............	267,094,345	244,371,147	213,159,743	205,691,715	221,175,330	229,907,884
Average Retail Sales—Dollars Per Store Per Week.....	954	941	848	861	968	1,018
Index Numbers—Base, 1930=100:						
Total Sales—Dollars	100	92	80	77	83	86
Retail Sales Per Store Per Week..	100	99	89	90	102	107
STORES						
In Operation at End of Year:						
Grocery......................	5,165	4,884	4,737	4,400	4,352	4,250
Meat.........................	2,990	2,869	2,845	2,767	2,748	2,653
Average Number Operated During Year:						
Grocery......................	5,302	4,980	4,816	4,573	4,356	4,286
Meat.........................	3,033	2,889	2,877	2,815	2,745	2,694
Licensed Piggly Wiggly Stores At End of Year..............	2,767	2,558	2,143	1,979	1,836	1,544
EMPLOYEES						
Number Full-Time Employees At End of Year..............	20,072	18,906	18,367	20,872	22,023	21,611
BALANCE SHEET STATISTICS						
Current Ratio..................	3.13	4.27	4.81	4.60	4.35	4.85
Cash, U. S. Government and Municipal Securities:						
Dollars......................	6,587,755	7,884,339	12,035,381	9,890,785	9,091,800	10,837,664
Ratio to Total Current Liabilities	.72	1.27	2.00	1.48	1.21	1.57
Inventories—Dollars............	19,937,671	16,443,597	14,589,421	18,627,029	20,916,910	20,129,097
Fixed Assets in Percent of Total Assets.......................	38	39	32	29	28	28
Net Working Capital...........	19,583,517	20,278,307	22,920,966	24,138,697	25,202,194	26,550,609